

M. RESULTS OF REVOCATION OF IRC 501(c)(3) ORGANIZATIONS

1. Introduction

The purpose of this article is to discuss the results of the revocation of an entity's IRC 501(c)(3) status. Both the substantive and the administrative aspects of the subject will be treated. Where there are unresolved issues, these will be noted.

2. Rulings and Determination Letters Recognizing IRC 501(c)(3) Exemption and Revocation of Exemption: General Rules

In 1965, Commerce Clearing House, Inc., published an article, "The Four R's: Regulations, Rulings, Reliance and Retroactivity - A View from Within", written by Mr. Mitchell Rogovin, then Chief Counsel of the Internal Revenue Service. In that article, Mr. Rogovin makes the comment that the letter ruling program "was developed to provide certainty as to the tax consequences of contemplated transactions and is concrete proof of the fact that even an agency as vast as the Internal Revenue Service can be responsive to the need of the public." The letter ruling program grew out of a procedure where the Commissioner entered into binding closing agreements with respect to prospective transactions. The closing agreement procedure proved to be too cumbersome to handle the volume of requests and, as a result, the letter ruling program was instituted.

A ruling or determination letter that recognizes exemption under IRC 501(c)(3) is a written statement to an organization that applies the law to the facts and representations in an organization's Form 1023. Should that letter recognizing exemption be revoked, as long as (a) there has been no misstatement or omission of material facts, (b) the facts subsequently developed are not materially different from the facts and representations on which the ruling or determination letter was based, (c) there has been no change in the applicable law, and (d) the organization acted in good faith in reliance on the ruling or determination letter, the revocation will be prospective. See Rev. Proc. 84-46, 1984-1 C.B. 541.

It is critical to remember for purposes of this topic that a ruling or determination letter recognizing exemption under IRC 501(c)(3) is a finding by the Service on how the law applies to a particular organization. Based on that finding, the Service will treat an organization for administrative purposes as one described in IRC 501(c)(3). When an organization's ruling or determination letter is revoked, that

treatment will cease. The organization, however, can challenge the Service's revocation either in a deficiency or refund action for prior years or in an IRC 7428 declaratory judgment action, since the revocation has the effect of cutting off continued reliance on the ruling or determination. Moreover, the organization can reestablish recognition of exemption for future years by filing an application for recognition of exemption on Form 1023.

3. Status of the Organization After Revocation

A. Years Under Examination

As already noted, when the Service revokes an organization's exempt status under IRC 501(c)(3), it is making a finding that, for the years under examination, the organization is not described in that subsection. Unless an organization's revocation is not retroactive (see above), the Service, for administrative purposes, treats the organization as a taxable entity required to file tax returns, Form 1120, if a corporation, or Form 1041, if a trust. The tax returns for the years in question are solicited by the EO specialist after the final revocation letter is issued or if the organization agrees to revocation. (IRM 7(10)(12):5 provides that the EO specialist should solicit the "appropriate" returns, that is, returns for all years at issue.)

If the organization furnishes the tax returns, they are forwarded to the appropriate Service Center for processing. The Service Center establishes the filing requirement on the organization's master file account, so that it would receive delinquency notices in future years if it fails to file without reestablishing exempt status.

If the organization does not comply with the EO specialist's request to file returns, EP/EO takes no further action beyond notifying Examination Division that returns were solicited but not furnished. Examination Division is then responsible for securing the returns.

The provisions for handling revocation are set forth in IRM 7(10)(12)2. (IRM 7(10)10, Delineation of Examination Responsibilities Between District Employee Plans and Exempt Organizations Division and Examination Division, also should be consulted.)

IRM 7(10)(12)2:6 provides that Form 5666, EP/EO Information Report, is prepared in all revocations. If a case is sent to Appeals, the Form 5666 is prepared

beforehand. If Appeals sustains the revocation, it forwards Form 5666 to the appropriate Examination Division.

IRM 7(10)(12)2:8 provides that the "Form 5666 will recommend examination for either the first year for which the organization is a taxable entity or for an appropriate subsequent year." It also lists the information that must be submitted with the Form 5666, including (a) a statement that the organization's exempt status has been revoked; (b) the effective date of revocation; (c) a copy of the revocation letter; (d) the date the organization was incorporated or formed; (e) a statement that, as a taxable entity, the organization should be reporting any income, employment, and excise taxes for which it may be liable; (f) a statement that contributions to the organization are no longer deductible as charitable contributions (if the organization was an IRC 501(c)(3) organization) and a list of substantial contributors; (g) the effective date that contributions are not deductible; (h) a copy of any taxable returns that have been obtained and a statement that the originals have been obtained by EP/EO and forwarded to the service center; (i) if no tax returns has been obtained, a recommendation that the return be obtained by the Examination Division; and (j) pertinent financial or other information or documents.

B. Revocation and Future Years

It has already been noted that an organization whose IRC 501(c)(3) exempt status has been revoked may reapply on Form 1023 for recognition of exemption. This leads to the obvious question: What is the status of a revoked organization for subsequent years, when it does not reapply for recognition of exemption under section 501(c)(3)? Here we must distinguish between the organizations not subject to IRC 508(a) and those that are. To understand this distinction a brief review of IRC 508 is in order.

IRC 508(a) states that, except as provided in IRC 508(c), an organization organized after October 9, 1969, shall not be treated as an organization described in IRC 501(c)(3) unless it has given notice to the Secretary, in such manner as the Secretary may by Regulations prescribe, that it is applying for recognition of such status. Reg. 1.508-1(a)(2)(i) provides that the notice described in IRC 508(a) "is filed by submitting a properly completed and executed Form 1023, Exemption Application."

As noted above, organizations described in IRC 508(c), such as churches, are exempted from the IRC 508(a) notice requirement. Therefore, a church is not required to give notice that it is applying for recognition of exempt status under IRC

501(c)(3). See Reg. 1.508-1(a)(4), which provides: "Any organization excepted from the requirement of filing notice under IRC 508(a) will be exempt from taxation under IRC 501(c)(3) if it meets the requirements of that section, whether or not it files such notices."

Therefore, where churches are involved, although an organization must satisfy the requirements for exemption under IRC 501(c)(3), it need not either notify the Service that it claims exemption or be the subject of a Service determination that it is exempt. Reg. 1.508-1(a)(4) clearly provides that a church that does not apply for exemption by filing Form 1023 nevertheless may be exempt under IRC 501(c)(3) if it meets the requirements of that section. Consequently, a church (or other organization described in IRC 508(c) that has been revoked), may claim to be exempt for future years without going through the process of applying for recognition of exemption under IRC 501(c)(3), nor does it need a Service determination that it is exempt under that subsection.

Revoked organizations subject to IRC 508(a) are a different matter. One point of view holds that since they satisfied IRC 508(a) once (otherwise they would not have been recognized as exempt under IRC 501(c)(3) in the first instance), their position after revocation is analogous to the organizations described in IRC 508(c) - they need not reapply for and once again receive recognition of exemption under IRC 501(c)(3) in order to claim exemption under that subsection. There is a G.C.M., however, that casts doubt on the correctness of this position. G.C.M. 38997, June 10, 1983, is concerned with an organization that complied with the IRC 508(a) notice requirements but subsequently withdrew its application. The G.C.M. concludes that the withdrawal effectively negated the compliance with IRC 508(a) and prevented the organization from being described in IRC 501(c)(3). The reasons for this conclusion are stated as follows:

...Congressional intent underlying section 508(a) further reveals that section 508(a) was intended to require an organization to make its existence and claimed status known to the Service. S. Rep. No. 91-552, 91st Cong. 1st Sess. 54 (1969), 1969-3 C.B. 423, 459.

While (the organization) complied with the specific requirements of section 508(a) and section 1.508-1(a)(2)(i) by providing the specified notice (including claimed status) to the Service within 15 months, the notice must maintain that the organization is claiming that it is described in

section 501(c)(3). (The organization) has affirmatively negated its claim to section 501(c)(3) status by withdrawing its application for recognition of exemption. At this point, the Service is aware of the existence of the organization but it can no longer be said that the Service is aware of the organization's claim to section 501(c)(3) status... .

In our opinion the affirmative act of withdrawal negates the previous notification provided to the Service since the organization has withdrawn its claim to section 501(c)(3) status. Therefore, (the organization) has not met the notification requirement of section 508(a) and section 1.508-1(a)(2)(i), and cannot be treated as an organization described in section 501(c)(3) even though its purpose is one which is enumerated in section 501(c)(3).

It is noted that there is a fundamental difference between the situation where an organization withdraws IRC 508(a) notice and an organization that does not give IRC 508 notice after revocation - withdrawal of notice is an affirmative act. Nevertheless, in both cases there is a lack of satisfaction of what the G.C.M. describes as the fundamental intention of IRC 508(a) ("to require an organization to make its existence and claimed status known to the Service"). Therefore, it is open to question whether a revoked organization must satisfy the provisions of IRC 508(a) in order to be treated as an IRC 501(c)(3) status for periods subsequent to revocation.

4. Revocation and Charitable Contributions

A. Deductibility of Contributions in General

IRC 170, with certain limitations, allows deductions for federal income tax purposes for contributions or gifts made to or for the use of an organization that qualifies as an organization described in IRC 170(c). The categories of donee organizations described in IRC 170(c)(2) are, with minor exceptions, identical to those described in IRC 501(c)(3). In order for contributions by donors to be deductible, the organization must qualify as an organization described in IRC 170(c) at the time of the contribution.

B. Publication No. 78 and Rev. Proc. 82-39

The issuance of a favorable IRC 501(c)(3) ruling or determination letter in response to an application gives an organization's contributors advance assurance of deductibility of contributions. This is an administrative finding that, under the facts established during the application process, an organization qualifies as an organization described in IRC 170(c). Publication No. 78, Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code, is the primary mechanism used by the Service to provide advance assurance of deductibility.

The extent to which contributors may rely on the listing of organizations in Publication No. 78 for purposes of deductibility of contributions and the procedures by which such reliance may be suspended are contained in Rev. Proc. 82-39, 1982-1, C.B. 759. Section 3.01 of Rev. Proc. 82-39 states as follows:

Where an organization listed in or covered by Publication No. 78 ceases to qualify as an organization contributions to which are deductible under section 170 of the Code and the Service subsequently revokes a ruling or a determination letter previously issued to it, contributions made to the organization by persons unaware of the change in the status of the organization generally will be considered allowable if made on or before the date of an appropriate public announcement, such as publication in the Internal Revenue Bulletin, stating that contributions no longer will be deductible. Under certain circumstances, such as where a legally enforceable obligation under local law has been made to the organization prior to the date of publication and the satisfaction of such pledge is on or after the date, the allowance period may be extended upon specific exercise of authority under section 7805(b). See, for example, Rev. Rul. 78-129, 1978-1 C.B. 67. However, the Service is not precluded from disallowing a deduction for any contribution made after an organization ceases to qualify under section 170, where the contributor (1) has knowledge of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for, or was aware of, the activities or deficiencies on the part of the organization that gave rise to the loss of qualification.

Rev. Proc. 82-39 also states that IRC 7428 creates a remedy under declaratory judgment procedures, in part, for cases involving a determination by the Service with respect to the continuing qualification of an organization as one described in IRC 170(c)(2) or 501(c)(3), or to the continuing classification of an organization under IRC 509(a). The remedy is available in these cases when (1) the Service determines that revocation of exemption under IRC 501(c)(3), deductibility status under IRC 170(c)(2), or public charity status under IRC 509(a) is appropriate; (2) the organization has exhausted its rights to file a protest and have a conference as set out in Rev. Proc. 80-25, 1980-1 C.B. 667; and (3) the Service has issued a final adverse determination letter to the organization.

IRC 7428(c) of the Code provides for the "validation of certain contributions" made during the pendency of a proceeding for a declaratory judgment involving the revocation of a determination that the organization is described in IRC 170(c)(2). Under this provision, contributions from individuals (up to a maximum of \$1,000) and from other charitable organization described in IRC 170(c)(2) may continue to be deductible. Statutory protection for such contributions, if declaratory judgment is sought on the revocation action, would begin on the date of publication of the revocation and end on the date on which the court first determines that the organization is not described in IRC 170(c)(2). This reliance, however, is not extended to any individual who was responsible, in whole or in part, for the activities (or failures to act) on the part of the organization that were the basis for the revocation.

C. Revocation and Deductibility of Contributions In Future Years

No organization whose IRC 501(c)(3) status has been revoked and has not reapplied for recognition of IRC 501(c)(3) exemption may claim that contributions to it have an advance assurance of deductibility. Advance assurance of deductibility is only available to an organization that applies for and receives recognition of exempt status from the Service and that is listed in Publication No. 78.

There is distinction between representations of an advance assurance of deductibility and a claim to charitable status, however. While an individual contributor may only have advance assurance of deductibility if the conditions listed in Rev. Proc. 82-39 are met, contributors may be allowed a charitable deduction if they can establish that the organization is a qualified donee. It is certainly possible that a donor may do this in the case of a revoked organization not subject to IRC 508(a). Whether this may be done with a revoked organization to which IRC 508(a) applies and which has not reapplied and received recognition of exemption under IRC

501(c)(3), depends upon a resolution of the issue discussed above, of whether the organization must reapply for exemption under IRC 501(c)(3) in order to claim charitable status.